

**BEFORE THE
UNITED STATES SENATE
COMMITTEE ON
COMMERCE, SCIENCE, AND TRANSPORTATION**

**TESTIMONY OF
CLARK MCLEOD
CHAIRMAN AND CO-CEO
MCLEODUSA INCORPORATED**

**CONCERNING
LOCAL COMPETITION**

**McLeodUSA Incorporated
McLeodUSA Technology Park
6400 C Street SW
P.O. Box 3177
Cedar Rapids, Iowa 52406-3177**

June 19, 2001

Summary of Testimony of Clark McLeod

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McLeodUSA provides competitive telecommunications services to residential and business customers in 25 states. We also serve rural and urban markets. We currently provide a bundle of local, long distance and high-speed DSL and other data products.

H.R. 1542 has no redeeming qualities. It guts key open access provisions of the '96 Act and strengthens the Bells' monopoly control over the local network. This bill created uncertainty, which cut off CLEC access to capital. This bill would move us toward remonopolization of all telecommunications industries by the Bell companies. I urge you to publicly oppose H.R. 1542.

Local competition has developed much slower than long distance competition. The reason is that the Bell companies have successfully denied competitors equal access (both economic and functional) to their local network.

In order to open up the local network to competition, we should review the successful models in the long distance market and the wireless market. Access led to competition, which led to lower prices and higher service quality for customers.

The answer for local competition is to mandate equal access and enforce it. Unfortunately, there is not equal access today, either economic or functional.

Economic equal access does not exist today, because competitors are not getting what they pay for. Competitors pay for 100% service from the Bells but receive far less. Consequently, competitors must receive damages to offset the costs they incur as the result of unequal access. Alternatively, the price competitors ~~the~~ pay the Bells should be discounted (similar to the long distance feature group A discount).

Functional equal access also does not exist. Competitors must be able to order, provision and service lines in the exact same way the Bell company does. A system is needed within a Bell company that does not reveal who the ordering company is, thus eliminating the ability to discriminate. Until that occurs meaningful and progressive penalties must be assessed when the Bells discriminate.

Separation of retail and network operations is critical to functional equal access. Separation can occur functionally within a company, which is the system Qwest is implementing. But, if meaningful separation does not occur, regulator must have the authority

and budget to structurally separate the Bells' retail and network operations and must use it to accomplish functional equal access.

On behalf of McLeodUSA, I would like to thank the Committee for the opportunity to talk with you today. I would like to accomplish three goals: first, highlight McLeodUSA's progress in serving residential and business customers in rural and urban markets; second, briefly summarize our opposition to H.R. 1542, which moves us toward re-monopolization of all telecommunications industries by the Bell companies; and third, highlight the keys to local competition.

I. McLeodUSA is exactly what Congress envisioned.

A. Entrepreneurial

In the early 1980s, I was CEO of Teleconnect, a company founded to compete in the long distance industry. I started basically out of my garage and began to bring the benefits of competition to my customers. In 1981, the Federal Communications Commission (FCC) mandated AT&T to allow competitors access to its existing network. As public policies continued to encourage and support competition in that industry, several competitors, including Teleconnect, began to have success. Over the course of about 8 years we built Teleconnect into the fourth largest long distance company in the country employing nearly 7,000 employees. So I know entrepreneurial competition can work to bring competition to medium and small businesses and residences in your local communities.

In 1992, I organized McLeodUSA, headquartered in Cedar Rapids, Iowa, began competing in the local and long distance telephone markets. We started slowly. When the Telecommunications Act of 1996 ("the '96 Act") was passed, we were able to take our company public and accelerate our growth.

McLeodUSA's corporate team is recognized as one of the strongest management groups in the telecom industry: strong because of our breadth, and strong because of our depth.

McLeodUSA Incorporated is a Nasdaq-100 company traded as MCLD. The Company's Web site is available at www.mcleodusa.com.

B. Serving a Wide Range of Customers

We serve both business and residential customers. In fact we serve more residential customers than business customers. Our goal is to be the number 1 and most admired company in the markets we serve. We cannot accomplish that by only serving large business customers in large cities, so we rejected that model. The Bells like to portray competition as competitors who merely “cherry-pick” high-margin large business customers. In our case that portrayal is just not true.

We also serve a wide range of communities ranging from cities as small as a few hundred people up to cities as large as Chicago. In the communities we serve, our focus is primarily on small and medium sized enterprises. While we do serve residential customers and large businesses, we have found that small and medium-sized businesses are largely underserved. We have good success with those customers using our beat-cop sales approach that meets customers face-to-face. Currently our average business customer has 6 telephone lines. So again you can see we are not in this business to only serve the “high revenue” large business customers of the Bell companies. We are committed to taking competition to the small businesses along Main Street as well as to the residences of your constituents.

II. McLeodUSA is bringing competition and its benefits.

McLeodUSA is the largest independent CLEC in the country. In March 1996 we served approximately 40,000 local access lines. Today, we serve over 1 million lines.

A. Jobs

In late 1994 we had approximately 200 employees, primarily in Iowa. Today we have nearly 11,000 employees working in 150 offices located in 25 states.

B. Technology

At the end of the first quarter of 2001, we had 50 central office and long distance switches and 396 data switches in operation. In addition we had deployed and begun operating approximately 29,000 route miles of fiber optic cable connecting most of those facilities. By the end of 2002, we will operate a 30,000-mile broadband network connecting 810 cities capable of delivering service to a local telephone connection (the “local loop”) for 90% of the U.S. population. See Exhibit 1. The one critical missing requirement for meaningful local competition, however, is for competitors to have equal access (functional and economic) to the Bell local network . . . the entire local network.

III. H.R. 1542 moves us toward Re-Monopolization of All Telecommunications Industries by the Bell Companies.

Let me get immediately to the point: H.R. 1542 has no redeeming qualities. It guts key equal access provisions of the '96 Act and strengthens the Bells' monopoly control over the local network.

It does nothing to spur broadband investment in rural America.

It is totally irrelevant to the Bells' ability to provide DSL service. The Bell companies can and do provide broadband DSL service today.

It substantially reduces the Bells' incentive to open their local markets to competitors, by granting immediate authority to provide long-distance “data” services.

This bill created uncertainty, which cut off CLEC access to capital.

Consequently, I urge each of you to publicly oppose H.R. 1542.

IV.Keys to Local Competition

Today, we are at the beginning of providing consumers a competitive choice for their local telecommunications service. Five years after the '96 Act, all competitors (independent CLECs, AT&T, Worldcom and Sprint) have gained 8.5% share of local access lines. In contrast, competition in the long-distance industry during the 1980s developed much faster. Five years after the 1984 divestiture of AT&T from the Bell companies, all long-distance competitors had gained nearly 4X the marketshare that competitors have gained in local access lines.

Why has local competition been slow to develop? The answer is that the Bell companies have successfully denied competitors equal access (both economic and functional) to their entire local network. See Exhibit 2.

How do we open up the local network to competition? Let me describe two successful models used in the long distance market and the wireless market.

First, long distance. The two keys actions that allowed competition to flourish in the long distance industry was that equal access was mandated and enforced. In 1981, the FCC mandated that all competitors have access to the AT&T network. In 1986, equal access from the Bells was mandated, thus allowing 1+ dialing. Additionally, Judge Greene provided strong enforcement, including meaningful penalties, to deter anti-competitive conduct. The result was healthy long distance competition, an approximate 40% decrease in prices since 1993 and higher service quality for all customers. I can personally testify to this market opening during the '80s as the founder of the 4th largest long distance company in the '80s. See Exhibit 3.

Second, wireless. For the first 10 years, the wireless industry was a duopoly. Even though technology made great strides, prices remained artificially high. The FCC then opened up additional spectrum, thereby allowing equal access to more providers. Real competition developed and prices decreased over 50% since 1993. See Exhibit 3.

What do these two models have in common? Equal access to customers. So what is the answer for local competition? It is very simple. Mandate equal access.

QWEST has shown some positive improvement, but unfortunately, there is not equal access today, either economic or functional.

A.Economic Equal Access

First, economic equal access. Competitors are not getting what they pay for. For CLECs, local access today is the equivalent of paying your monthly bill to the local power company but also having to purchase and operate your own power generator to guarantee the lights stay on. Competitors pay for 100% service from the Bells but receive far less. Not only do competitors receive less than 100% of what they order from the Bell companies, current local access rules cause competitors to lose money while ensuring the Bells make a profit. See Exhibit 4.

So how do we enforce economic equal access? There are two alternatives. Competitors must have the price they pay the Bells discounted like was done successfully with long distance (the feature group A discount). Or, in the alternative, award damages for costs competitors incur when less than 100% service by the Bells is provided. We know damages will accomplish our goal. With QWEST, we have seen positive trends in its responsiveness, service delivery and creativity, all of which have contributed to a significantly improved business relationship. This result is attributable in part to the fact that QWEST pays penalties related to performance problems directly to us.

B.Functional Equal Access

Functional equal access means competitors are able to order, provision and service lines in the exact same way the Bell company does. This seems like common sense, but we

don't have it today. A system is needed within a Bell company that does not reveal who the ordering company is, thus eliminating the ability to discriminate.

So how do we enforce functional equal access? Progressive penalties can be imposed against the Bell companies when they engage in discriminatory conduct. Some have suggested up to \$10 million, but \$10 million is too low by several orders of magnitude. Imagine a \$10 million fine against a company with a \$100 billion market cap. It's the equivalent of a parking meter violation.

During last year, the Illinois Commerce Commission fined the incumbent provider \$60M. In response to these payments, one Illinois legislator was told that paying the \$60 million fine was simply a “cost of doing business.” Clearly penalties must be increased substantially in order to be meaningful.

Functional equal access can also be implemented by separation of network and retail operations with the incumbent provider. QWEST is working with competitors to implement adequate functional separation and non-discrimination practices. Other Bell companies are not. If penalties do not result in functional separation, then state and federal regulators should be authorized to structurally separate the Bell companies. They need the authority and the budget to carry out the separation, and if they do not determine separation has occurred they should use this authority.

Conclusion

Competitors, after spending billions of dollars, have averaged a 1% marketshare gain per year. If you extrapolate, there will be no one in this room still alive by the time we have meaningful local competition. And in fact, competition may die enroute. Congress needs to finish what was started in 1996 and take action now to mandate equal access and enforce it.